

# Memorandum

**TO:** ENVISION SAN JOSE 2040  
**SUBJECT:** Fiscal Report Review

**FROM:** Paul Krutko  
**DATE:** May 24, 2010

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## INFORMATION

San Jose Office of Economic Development (OED) staff has prepared the following commentary on the assumptions underlying the Fiscal Analysis Report that was provided to the Envision Task Force for the February 22, 2010 Task Force meeting. The information is intended to inform expectations related to anticipated revenue generation from the retail portion of mixed use projects built through implementation of the Envision 2040.

## BACKGROUND

To support the Envision San Jose 2040 process, the City engaged a fiscal consultant, Applied Development Economics (ADE), to prepare a Fiscal Analysis Report. The City's contract with ADE included the following elements:

- Model existing land-use fiscal impacts
- Analyze implications of the City's current fiscal condition on demand for City services
- Analyze the service demands versus revenues generated by general land use categories
- Analyze cost/revenue effect (fiscal impact) of five future growth scenarios

OED staff fully supports the Envision 2040 vision emphasizing mixed-used, concentrated development and improvement in the city's jobs/housing ratio. OED supports the positive impacts that can be fostered through mixed use development including: the creation of projects that build inviting spaces; unique amenities, and densities that do attract users and uses only found in urban areas. Mixed use projects also further the goals of the City's Green Vision.

## ANALYSIS

ADE's straightforward approach for the revenue projections in the fiscal report was based on current conditions and generalized citywide data for each land use type. Their approach assumes a constant per capita spending into the future. For comparison sake, a somewhat different approach was undertaken by OED which analyzed data on sales tax revenue on a per square footage basis. The data used by OED reflects sales that are currently supported by existing neighborhoods. In addition, OED's own experience in marketing and locating retail development in the City suggests that factors such as visibility, traffic counts and neighborhood characteristics play major roles in the success of retail development. Based upon OED's experience with retail and in light of the two different approaches, OED staff would like to temper key assumptions in the ADE report that can influence the fiscal outcomes of the model.

- *Stable Retail Revenue Per Capita.* In the model, per capita retail revenue is assumed to be fixed over time. Historical and projected trends in consumer spending demonstrate a continuous shift in consumer spending dollars towards services and away from consumer goods. Within the declining share of consumer dollars spent on consumer goods, a greater proportion is spent through on-line purchases. Increased expenditure on services and increased internet purchasing will likely continue to dampen the amount of sales tax that the City can generate. (See Chart A)
- *Substantial Retail Sales Tax Generation from Mixed-Use Retail.* The Report analyzed Land Use Study Scenarios which were developed based on an assumption that a substantial amount of new retail capacity will be provided through new mixed-use development. A mixed-use project with high-end or large-scale retail, like Santana Row, could generate enough City revenue to offset the costs incurred to the City by the residential component of the project. However, the more typical mixed-use development area would include smaller-scale neighborhood-serving retail, with a large concentration of restaurants, coffee shops, and service businesses. OED sales tax analysis of existing neighborhood shopping districts shows they generate on the order of \$.24 sales tax per square foot annually, compared with \$.90 for Santana Row. The Santana Row project is very unique, and it is not likely that future mixed use projects will match the revenue generation of the Santana Row project. (See Chart B)
- *100% Capture Retail Activity.* The report used an ideal capture rate of 100% capture of new retail sales tax activity from the new population and job growth. Historically, San Jose has had an average capture rate of 80%. The current retail revenue per capita shows the City is 20% under retailled. (An addendum to the Report describes the fiscal results of a more conservative 80% retail revenue capture rate. Under this 80% capture rate, net revenue reductions range from about \$20.5 million per year for Scenario 5 to about \$8 million for Scenario SJ2020, which turns negative as a result.) (See Chart C)
- *Adequate Retail/Commercial Lands.* ADE did not analyze the five Land Use Study Scenarios to determine if they included adequate sites to accommodate the level of new retail development needed to support a 100%, or even 80%, retail activity capture rates. (Such an analysis was not feasible at the time from ADE because the Land Use Diagram was still under development, and because this was not in their scope of work). While Envision 2040 incorporates some land for the kind of large-format retail that generate substantial sales tax, the reality is that there are few sites available larger than 10 acres.

OED staff offer the Envision 2040 Task Force members two important conclusions.

ADE used standard econometric ratios underlying the assumptions they used in their model. Staff believes it is useful for the Envision 2040 Task Force to be aware of additional factors that will likely shape the generation of sales tax revenues in San Jose and Santa Clara County. The ADE Report likely over-emphasizes the benefit of new retail development that will be generated through mixed use projects in the future.

The possibility that mixed use retail projects will not yield anticipated sales tax revenues also points to the wisdom of continued support for the City's Industrial Land Use Policy. The Envision 2040 draft Land Use/ Transportation Diagram identifies multiple areas for the development of housing (particularly mixed-use housing) through the redevelopment of properties currently developed with a variety of other land uses in growth areas of the City. OED continues to recommend that the City not convert additional job- and revenue-producing land to uses that will further diminish the City's already distressed fiscal condition.

### **COORDINATION**

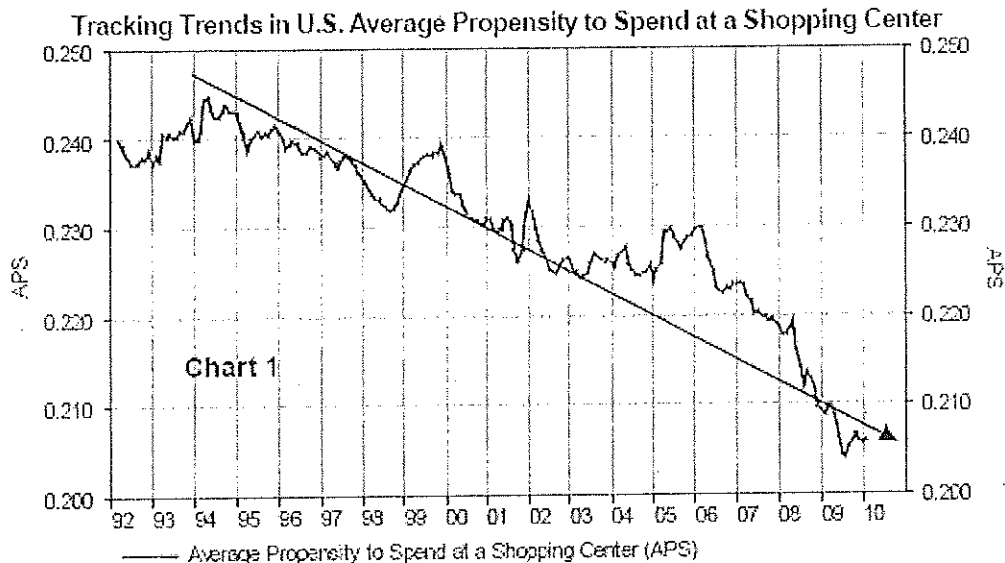
This memorandum has been coordinated with the Department Planning, Building and Code Enforcement.

A handwritten signature in black ink, appearing to read "Paul Krutko", with a stylized flourish at the end.

PAUL KRUTKO  
Chief Development Officer

### Chart A: Declining Propensity to Spend at a Shopping Center

This chart shows the decline in the propensity of American shoppers to spend at a shopping center. The average propensity to spend at a shopping center has fallen from \$.24 of every dollar to \$.21 over about 15 years. This decline is chiefly a function of the growth of expenditures in the service economy. In 1959, about 35 cents of every dollar went to consumer services. Today, that is about 63 cents.



Source: International Council of Shopping Centers

### Chart B: Comparison of Sales Tax Revenue for San Jose Shopping Areas

Shopping Area	Average Annual sales tax revenue/sq. ft.
Alameda Neighborhood Business District	\$.14
Lincoln Avenue (Willow Glen)	\$.34
Santana Row	\$.90

Source: OED analysis of STARS database

### Chart C: Assumptions About Sales Tax Capture

Net Fiscal Impact of Growth Scenarios Under Alternate Assumptions About Sales Tax (\$ millions)		
Scenario	100% Capture	80% Capture
SJ 2020	\$2.3	(\$6.2)
1	\$25.5	\$10.0
2	\$25.7	\$8.2
3	\$20.4	\$2.9
4	\$32.6	\$13.5
5	\$32.9	\$12.4

Source: ADE, Inc.